Saudi Arabia Commercial Market Review

Summer 2023

A quarterly review of key trends and the performance of Saudi Arabia's commercial market

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Office market

Riyadh

With around six months left before the Regional Headquarters Program (RHQ) is effective, a growing number of corporates are establishing their Middle East headquarters in Riyadh. Over 80 multinational businesses have already been granted licenses to be based in the Kingdom, with confidence in the fastest-growing G20 economy. The bulk of demand for office space is directed towards Riyadh.

Most businesses are looking to secure best-in-class offices, with locations such as King Abdullah Financial District (KAFD) and Laysen Valley topping wish list locations.

As a result of the growing demand, office lease rates registered a 13% increase over the 12-month period ending June 2023. Average lease rates for prime office space rose to approximately SAR 1,890 psm, up from SAR 1,675 psm. Occupancy levels currently stand at 98%, up by around 2 percentage points compared to this time last year.

The heightened demand is also reflected in the Grade B segment of the market, with rental rates rising by 15% over the past 12 months, reaching an average of SAR 975 psm. While lower-quality office spaces are not the first choice, the high lease rates and shortage of prime office supply is driving some occupiers to settle for ‘less-than-perfect’ alternative options in the Saudi capital.

Some larger businesses are exploring including build-to-suit options instead, joining a growing list of occupiers who have gone it alone, including the likes of Arabian Oud, Jarir and Alinma Bank.

We expect the strong demand to sustain and strengthen over the short term, meaning the market will likely remain landlord-friendly, at least until a significant quantum of supply enters the market. This is in stark contrast to McKinsey Global Institute’s projections of falling office demand across many of the world’s major urban centres through to 2030 (more details in page 4).

Just 100,000 sqm of supply entered the market during H1 2023, increasing the city’s supply to 5.2 million sqm. Over the next 3 years, and considering only projects that have broken ground, the city’s supply is expected to rise to 5.9 million sqm, with around 676,000 sqm to be added to existing stock.

Jeddah

Mirroring Riyadh, the demand for office space in Jeddah has been strengthening. Business activity in the coastal region is busier than ever. With several mega projects in the pipeline, many businesses, particularly those connected to the public sector, continue to expand.

Grade A rents currently stand at SAR 1,200 psm, reflecting a 15% increase compared to the same time last year. Meanwhile, Grade B rents increased by 9% over the past 12 months and hover at an average of SAR 780 psm. Rising demand is lifting occupancy levels across the board: Grade A office occupancy is currently at 95%, up from 90% during Q2 2022, while occupancy rates for Grade B offices is at 86%.

From a supply perspective, completions in Jeddah during the first six months of 2023 were limited, with just 28,000 sqm entering the market. The current office stock stands at 1.3 million sqm. By 2025, Jeddah’s supply is expected to rise by 3%, with around 41,000 sqm expected to enter the market. The shortage of suitable supply, against a backdrop of rising demand strongly hints at the continued growth in rents and the landlord favourable environment to persist.

DMA

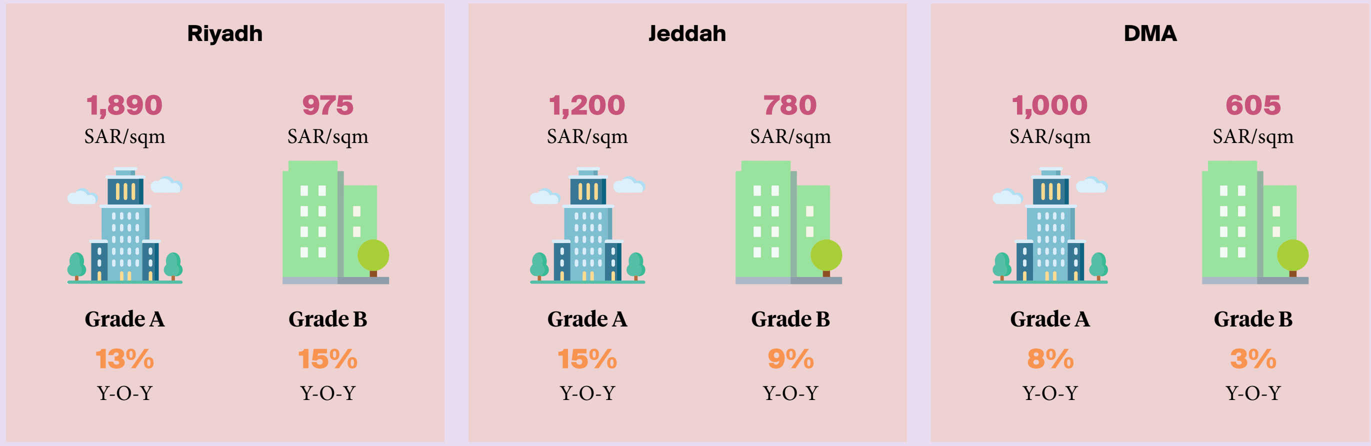
The Dammam Metropolitan Area (DMA) also saw positive office performance. The healthy demand and positive economic sentiment in the Eastern region resulted in an 8% rise in Grade A office lease rates over the last 12 months: lease rates climbed from SAR 930 psm to SAR 1,000 psm. In parallel, occupancy levels increased to 81%, up from 75% last year.

The positive trend is also evident in the Grade B segment, where rental rates rose by 3% compared to 2022, reaching an average of SAR 605 psm. Vacancy currently stands at 33%, down 2 percentage points from last year.

With around 46,000 sqm completed during the first six months of 2023, the current office stock stands at 1.3 million sqm. An additional 262,000 sqm is expected to be completed by 2025, representing a 25% increase. However, given historical materialisation rate, we are expecting some construction delays. Furthermore, we expect the additional supply to exert downward pressure on rental rates, especially in the Grade B segment as the majority of demand is directed towards high-quality offices, as is the case elsewhere in the Kingdom and indeed globally.

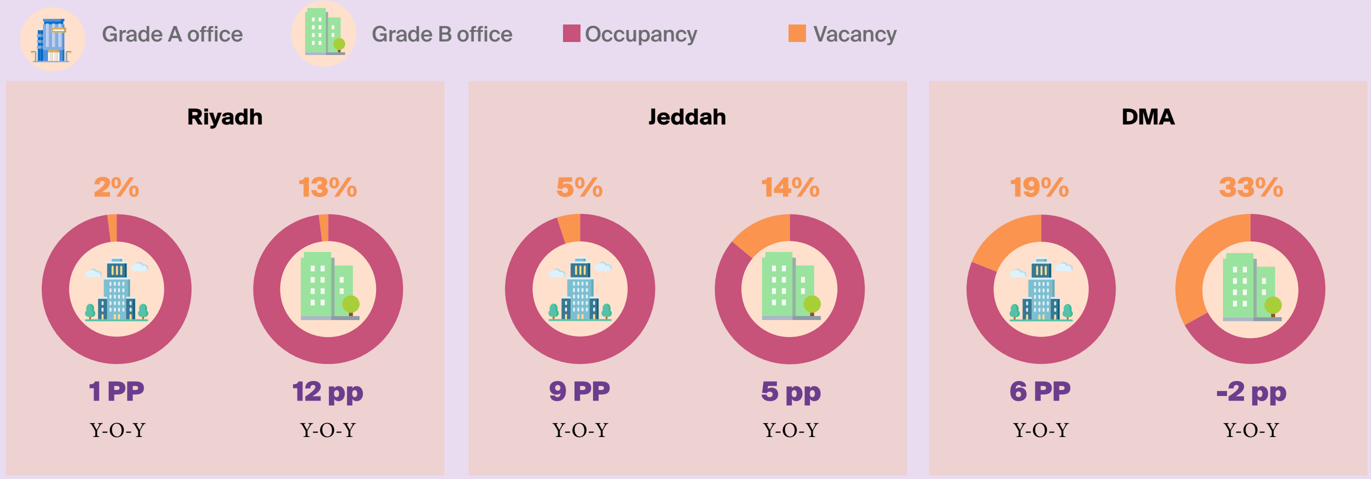
“Over 80 multinational businesses have already been granted licenses to be based in the Kingdom, with confidence in the fastest-growing G20 economy.”

Office lease rates - Q2 2023



Source: Knight Frank

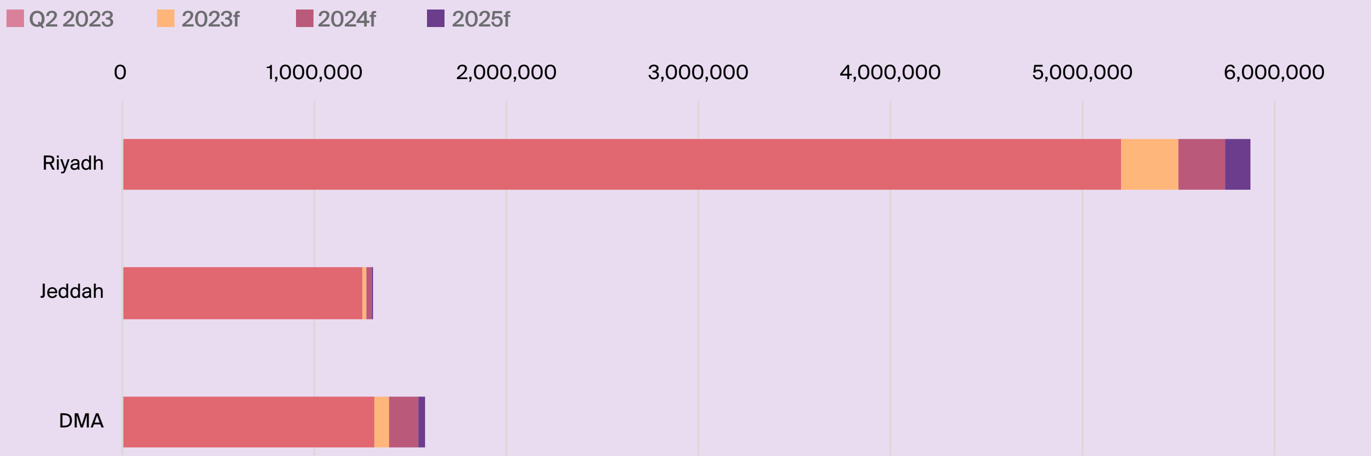
Office vacancy levels - Q2 2023



Source: Knight Frank

Office supply forecast

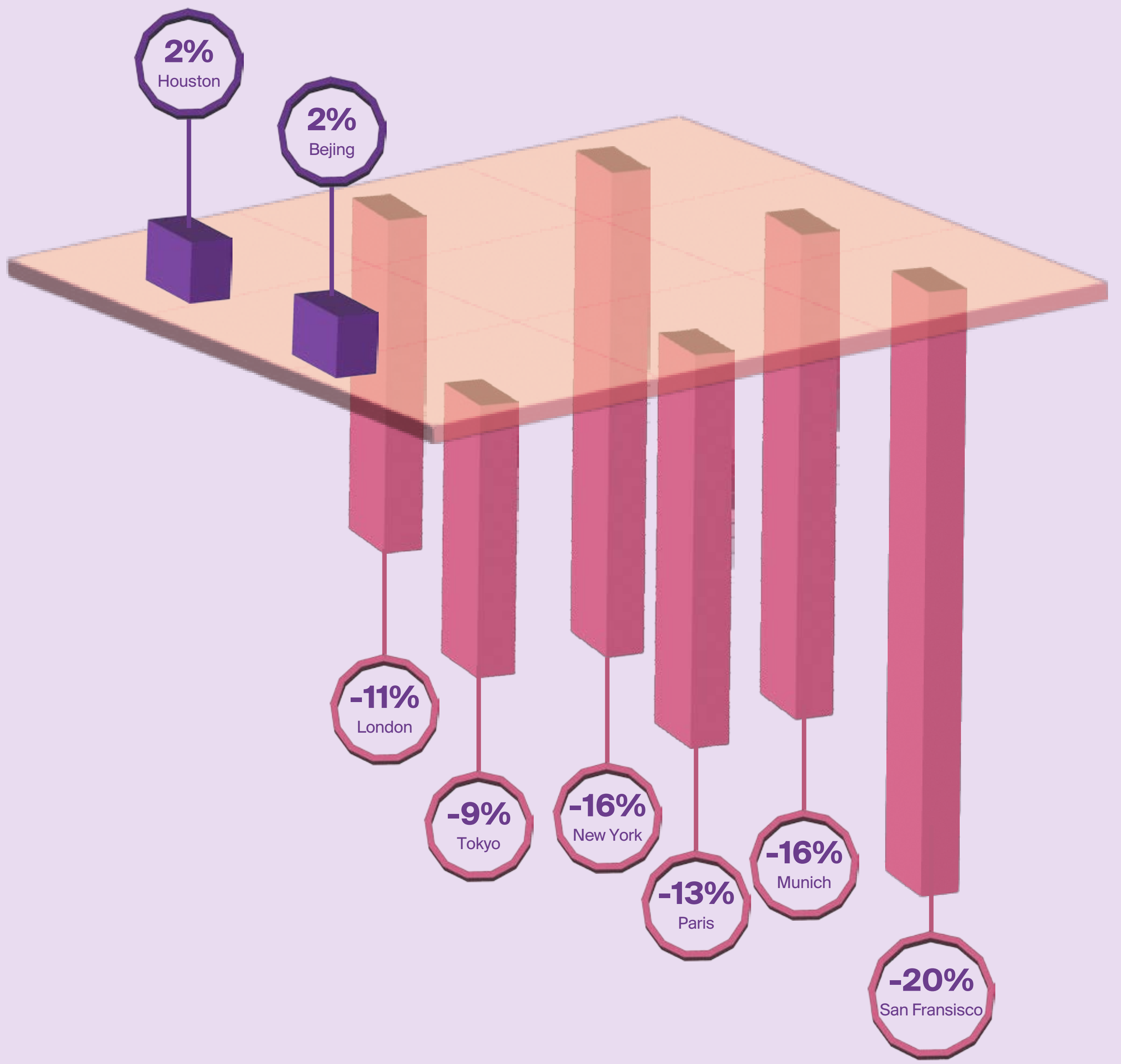
Sqm



Source: Knight Frank

Office market

Projected change in office real estate demand (2019 - 2030)



Source: Knight Frank, Mckinsey Global Institute

EXPERT INSIGHTS

Office demand in Saudi Arabia

“With Saudi’s economic diversification underway, coupled with the aforementioned Regional Headquarters Program (RHQ), Riyadh’s office real estate market finds itself in a much better place compared to its global counterparts.

Whilst the growth in rental values may moderate, occupancy levels are likely to decline in the coming years as a substantial pipeline of office projects come on stream and because current utilisation levels of more than 95% are not sustainable in the long run”

Harmen De Jong
Partner, Real Estate Strategy & Consulting

Retail market

Riyadh

In Riyadh, luxury and high-end retail has witnessed a surge in offerings with the recent opening of the 600,000 sqm Via Riyadh, for instance. With local and international luxury brands, art stores, fine-dine restaurants, and cafes, as well as a luxury cinema, the city's latest lifestyle retail destination has redefined extravagance, albeit with a local twist.

This trend of more high-end retail offerings mainly reflects the growing demand for luxury goods amongst a growing affluent client base as incomes climb and disposable income levels grow. Demand for luxury retail is also being underpinned by the projected growth in international visitors. Last year the Kingdom welcomed around 17 million international visitors and this figure is projected to approach 100 million by the end of the decade.

Away from the physical shopping experience, consumer preferences, particularly those aged 25 and under, or the 'Gen Z' population, are irrevocably linked to online shopping and e-commerce. Indeed our 2023 Saudi Report results echoed this, with shopping malls emerging as the least popular shopping venue among this age bracket, albeit malls remain popular overall, regardless of age.

Local businesses unsurprisingly remain focussed on establishing or boosting their online presence. While the market is currently dominated by international retail platforms, a recent survey by Kearney and Mukatafa revealed that 74% of online shoppers support buying local and are expecting to increase their purchases from Saudi platforms. The current e-commerce market in the Kingdom is valued at around 6% of total retail sales, and this is expected to increase by a further 7.5% by 2025 (Euromonitor).

The total existing retail supply in Riyadh stands at 3.5 million sqm, with around 90,000 sqm of retail space entering the market in the year to Q2 2023. We expect the retail stock to further grow to 4.4 million sqm by 2025, representing a 23% increase. Clearly the substantial uplift in supply will likely put pressure on retailers, mall operators and developers to ensure their offerings remain relevant, on trend and centred on experiences, if they are to effectively compete and survive the coming deluge of new supply.

Jeddah

Average rental rates across Jeddah's retail market have dropped during Q2 2023 for both regional and super regional malls. Lease rates declined by around 4% over the past 12 months to an average of SAR 2,500 per sqm. Occupancy rates across the retail market dropped marginally by 1% during the same period.

The slight drop in occupancy and rental rates in regional and super regional malls is partly a reflection of changes in consumer preferences, as outlined above. While the market-wide average lease rates dropped, developments with strong entertainment and lifestyle components continue to charge (and achieve) rental premia, with retailers happy to pay above average rates to benefit from access to strong and rising footfall.

That being said, recently opened developments, such as The Village Mall, located near King Abdullah Sports City's (Al Jawhara), offers a one-stop-shop that acts as a lifestyle and entertainment destination, and includes a hypermarket as well as standard shops.

From a supply perspective, after the completion of The Village Mall, the current retail stock in Jeddah is estimated at 2.5 million sqm. We expect an additional 470,000 sqm to be delivered by 2025, assuming no construction delays. Like Riyadh, the burden of the substantive increase in supply will lie firmly with mall operators and developers as they too will have to work hard to remain relevant in an increasingly competitive landscape.

DMA

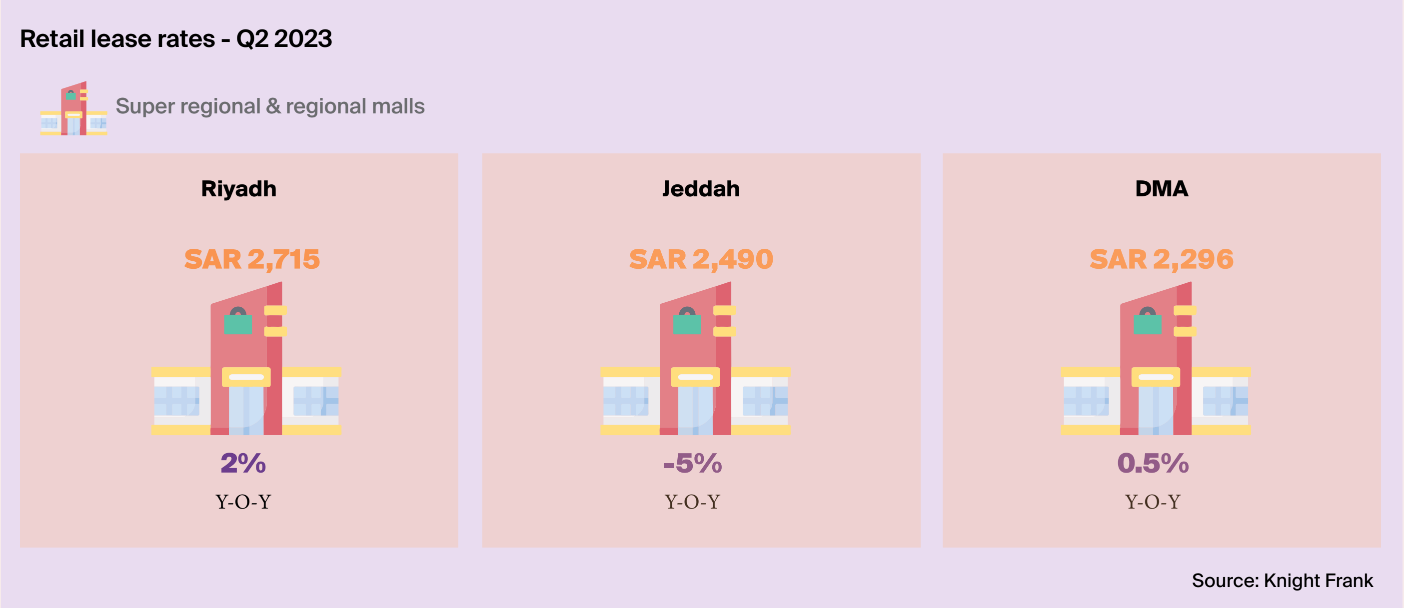
In contrast, the retail market in the DMA is somewhat subdued. While demand for regional and super regional malls is stable, rental rates increased marginally by 0.5%, reaching around SAR 2,300 in Q2 2023. Similarly, occupancy levels increased marginally by 1%, going from 89% to 90% during the same period.

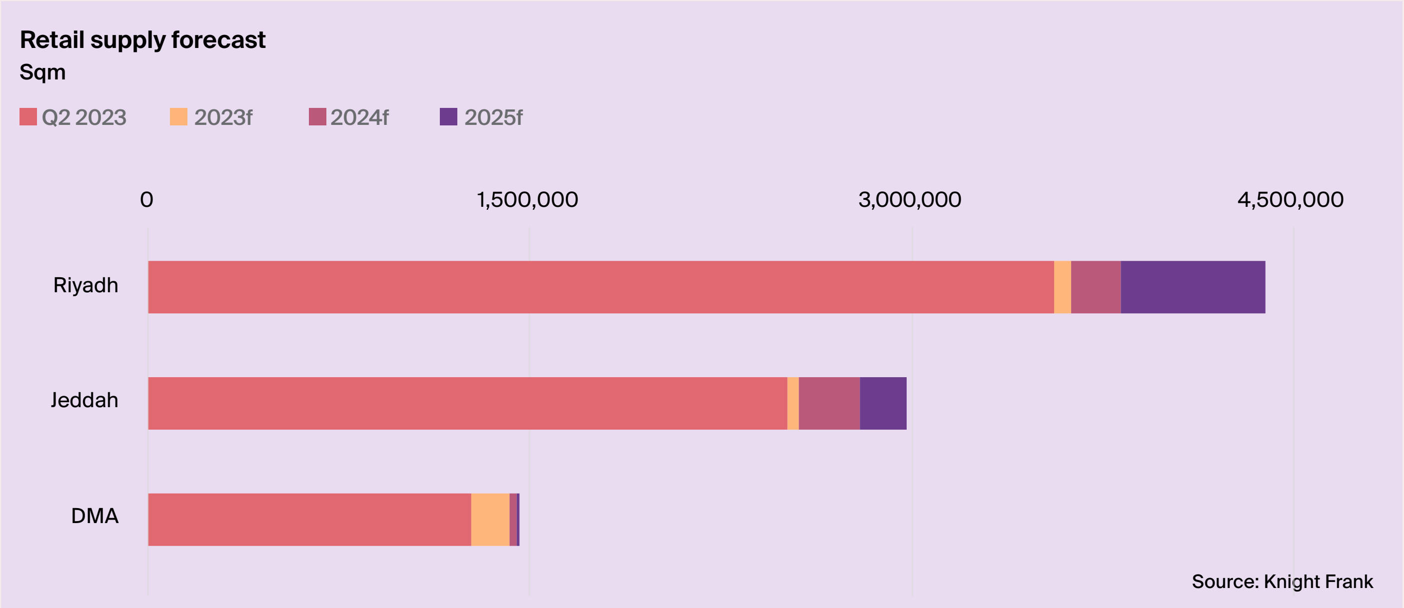
Mirroring elsewhere in the Kingdom, demand is directed towards retail developments with strong entertainment and F&B offerings. Tenants are looking to maintain a presence in well-managed developments, or secure space in new developments.

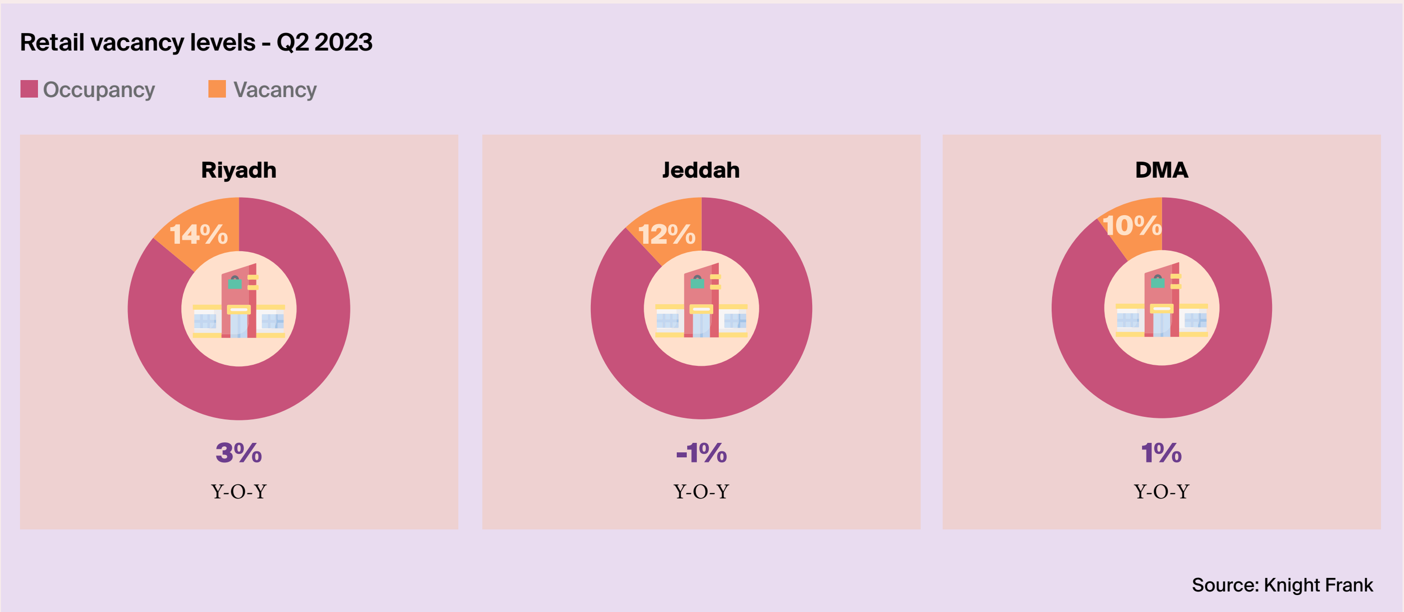
As with the rest of the Kingdom, the overall entertainment offerings are expected to be elevated in DMA with the Saudi Entertainment Ventures (SEVEN) planning to develop retail and entertainment destinations.

The flip-side of this is of course the subsequent impact on older developments and/or those that do not centre themselves on entertainment and experiences.

With no notable completions during the first half of the year, the current retail stock stands at approximately 1.3 million sqm. Considering only projects that have broken ground and assuming no construction delays, an additional 188,000 sqm is expected to be added to the supply by 2025.







Hospitality market

Riyadh

During the first half of the year, Riyadh saw occupancy levels slightly increase by 2 percentage points to reach 62%, compared to 60% last year. Average Daily Rates (ADR) edged up to SAR 735, representing a 13% increase compared to the same period last year. As a result, Revenue per Available Room (RevPAR) is up SAR 453 from SAR 393 in 2022 (STR Global).

Riyadh's year-round events and reawakening as the commercial hub for the Kingdom are contributing to the rising number of both leisure and business travellers.

Looking ahead, with the announcement of the fourth edition of the Riyadh Season, expected to start later in the year, we expect to see strong demand for hotel rooms after the usual summer lull.

From a supply perspective, the first six months of the year witnessed the addition of 600 new keys, increasing the supply to 20,800 keys. We expect the supply to grow by 23% to 25,600 keys by the end of 2025, assuming no construction delays. Most of this new supply (66%) will be concentrated in the 4 star and 5 star category.

Jeddah

Since the announcement of the Jeddah Calendar, which includes a series of cultural and entertainment events and festivals, punctuated by the F1 Grand Prix, the city has been attracting an increasing number of visitors.

Attractions such as the Islamic Art Biennale, which hosted over 600,000 visitors, broke regional records in terms of number of visitors to a Biennale. Additionally, Jeddah's vibrant summer calendar, filled with beach-related attractions, concerts, and cultural attractions, contributed to the positive hotel performance during the first six months of 2023.

As a result, between January and June of 2023, Jeddah's average occupancy levels rose to 64%, representing a 16% increase compared to the same period last year. Similarly, ADRs reached SAR 807, up from SAR 776 last year. Most importantly, RevPAR increased by 21% to reach SAR 516, around 14% higher than Riyadh (STR Global).

Besides attracting tourists, several political events took place in the coastal city, including the Arab League Summit, which took place in May, as well as the Security and Development Summit, attended by US President Joe Biden in July. The influx of high-profile visitors and their associated entourages to the city has undoubtedly contributed to the positive performance of its hospitality sector.

From a supply perspective, the current stock stands at around 12,700 quality hotel keys, and it is expected to rise by 6,000 keys by 2025. The additional supply includes hotels like Rixos (175 keys) and the Four Seasons (270 keys).

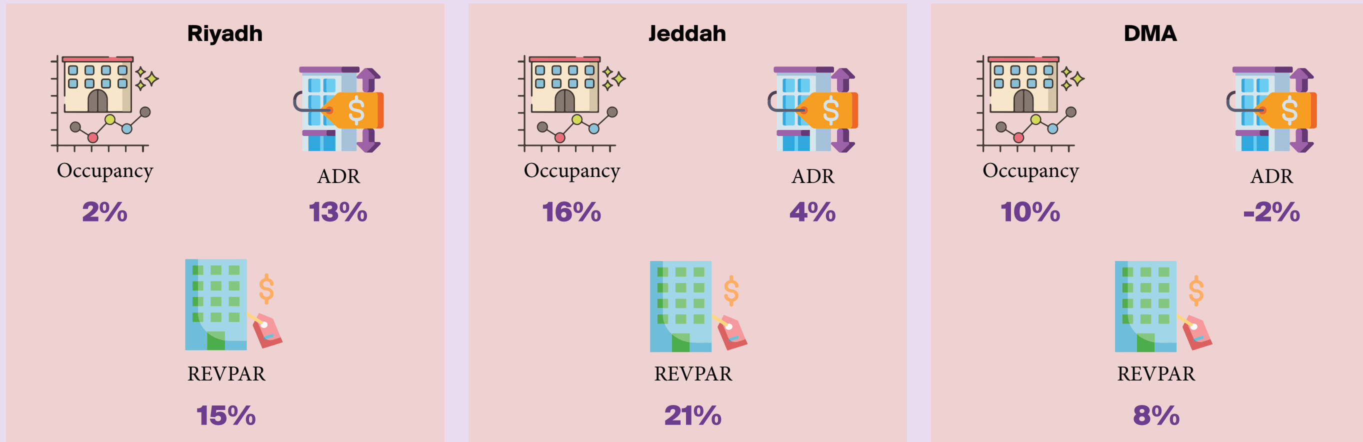
DMA

The hospitality market performance indicators we track in the DMA showed fragmented performance during H1. Between January and June 2023, ADRs fell by 2.1%, reaching around SAR 405. On the other hand, occupancy levels increased to around 60%, up 10% compared to the same period last year, the same time RevPAR climbed by 8% to reach an average of SAR 242 (STR Global).

During the remaining half of the year, we expect the hospitality market to be positively influenced by the recent announcement to ease visa regulations for GCC residents, allowing them to enter the Kingdom using e-visas. Due to DMA's geographic proximity to GCC countries, including Qatar, Bahrain, and UAE, DMA is likely to be the first stop in Saudi for those entering the Kingdom by road.

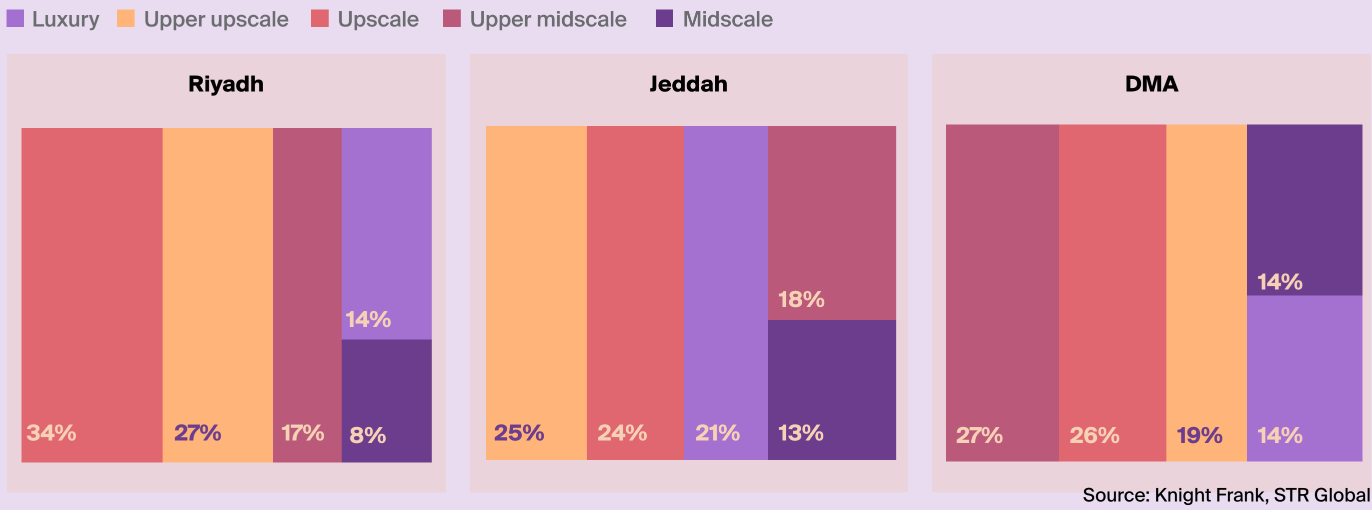
The total quality hotel supply currently stands at 12,700 keys. Assuming no further delays, and considering only projects that have broken ground, the total supply is expected to increase by 17% by 2025 with around 2,000 keys entering the market. The largest source of new supply will be the InterContinental Dammam (289 keys).

Hospitality market performance - YoY % change YTD June 2023



Source: Knight Frank, STR Global

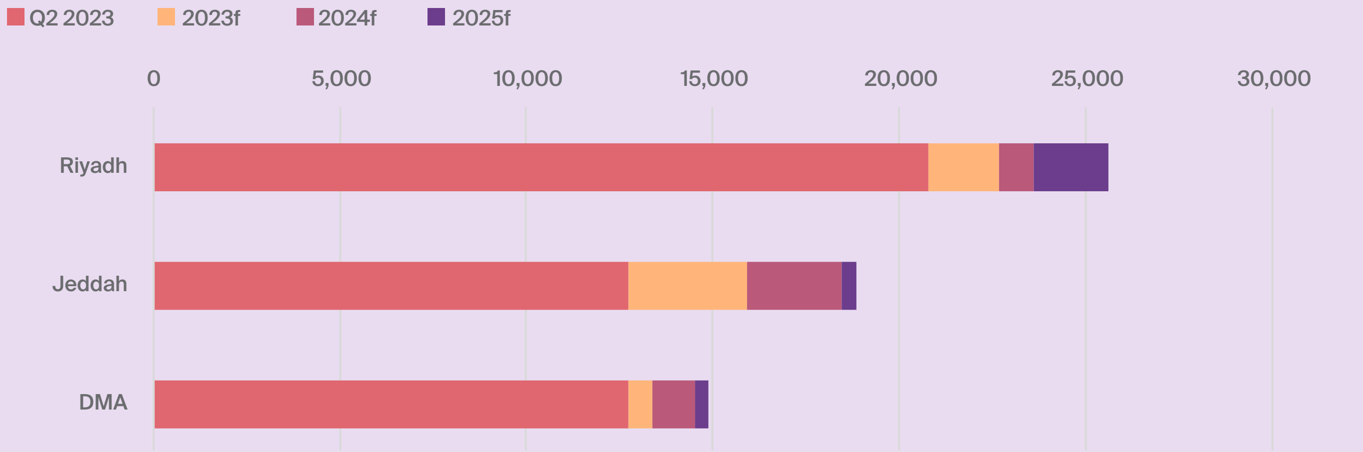
Existing quality hotel supply segmentation



Source: Knight Frank, STR Global

Hospitality supply forecast

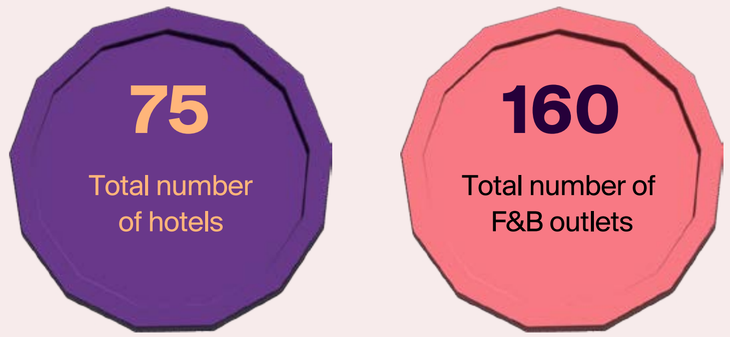
No. of keys



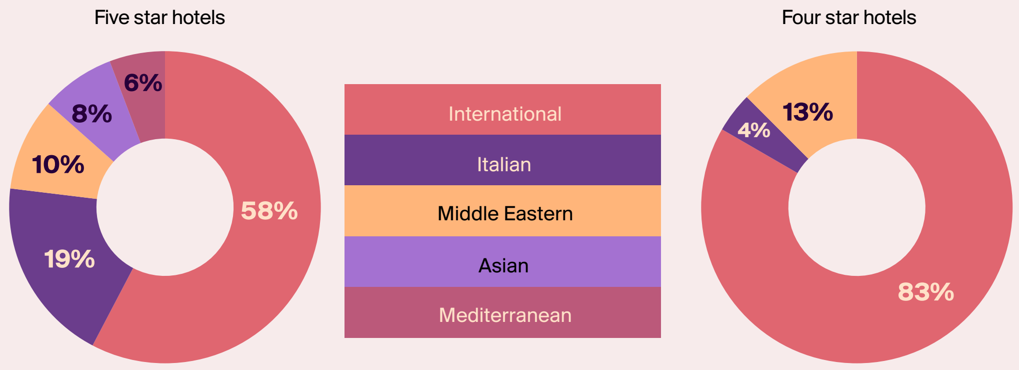
Source: Knight Frank, STR Global

4 AND 5 STAR DINING

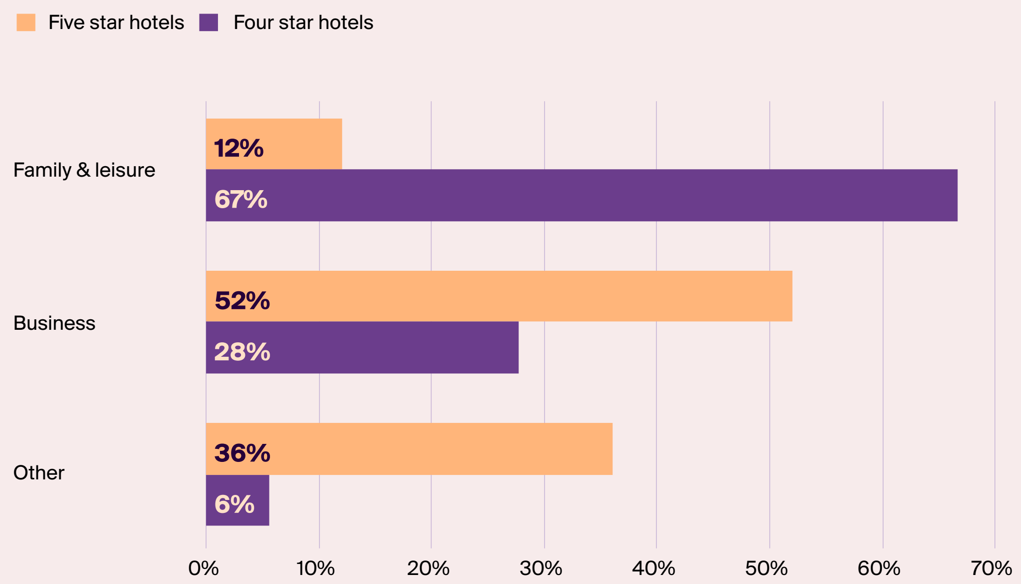
Number of F&B outlets



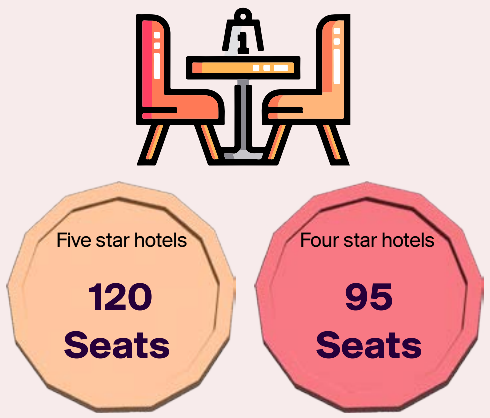
Cuisine type on offer



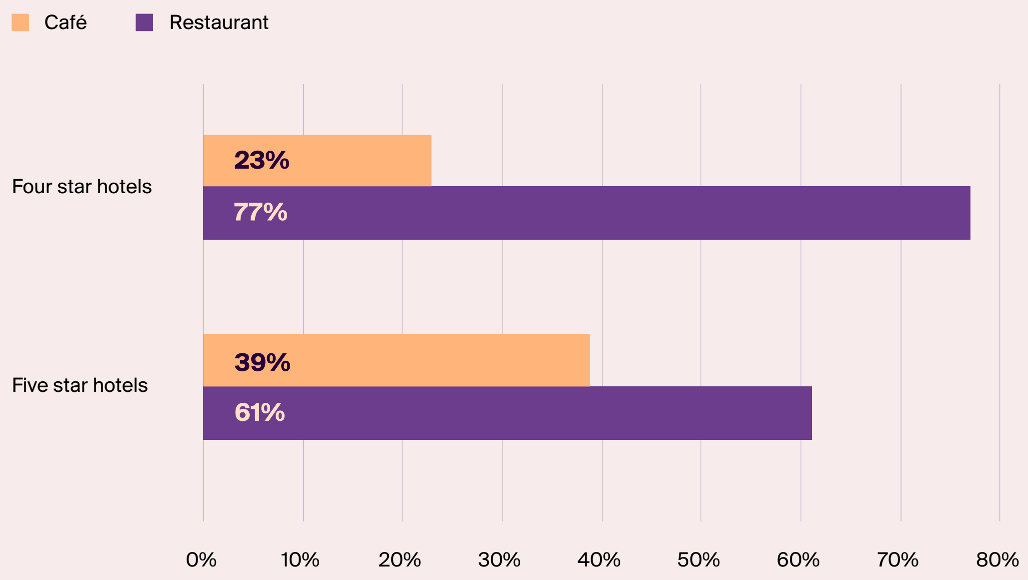
Visitor segmentation by the purpose of visits



Average seating capacity



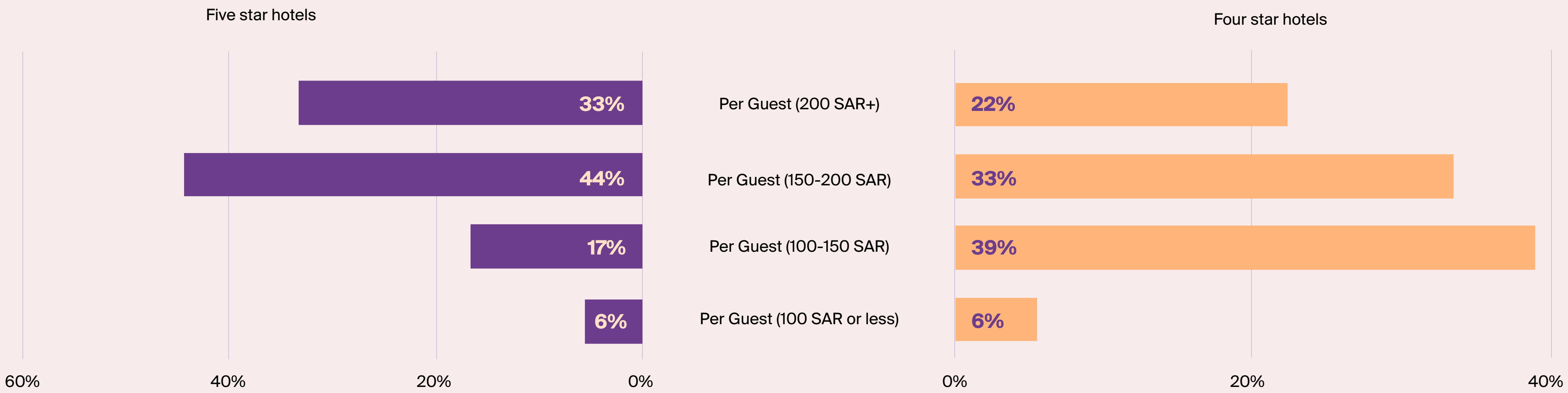
Share of restaurants vs café



Food serving style

	Five star hotels	Four star hotels
A la carte	21%	21%
Buffet	21%	42%
A la carte & Buffet	58%	37%

Average price range for buffets



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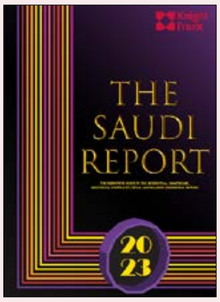

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